

## The effect of innovation capability on business performance: The role of social capital and entrepreneurial leadership on SMEs in Indonesia

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### ABSTRACT

The presence of small and medium-sized enterprises (SMEs) in Indonesia will contribute to the movement of the Indonesian economy, so its growth is an essential part that must be considered by the government. The goal of this study was to explore the role of innovative capabilities in improving the performance of Indonesian SMEs. A variable approach to social capital, entrepreneurial leadership, innovation ability and SME efficiency was used in this research. The research included a sample of 352 small and medium-sized enterprises in Pekanbaru, Indonesia, consisting of 19 medium-sized enterprises and 333 small enterprises out of a total population of 2887 small and medium-sized enterprises (the sampling methodology used was chance sampling and simple random sampling methods). The findings show that social capital does not explicitly have a substantial impact on the business performance of SMEs in Pekanbaru, but if it is mediated by creative capacities, social capital indirectly plays a role in improving the performance of SMEs. Entrepreneurial leadership has a big influence on SMEs.

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## 1. Introduction

Small and Medium Enterprise (SME) is one of the businesses that are currently in the spotlight which is classified as a tool for the economic growth of a country (Tengeh, 2011; Aidis & Saul, 2007). Small and Medium Enterprises (SMEs) in a country are considered to be better at coping with the crisis when compared to large businesses, although there are some SMEs who are also experiencing difficulties during the crisis. These businesses are known to be able to adapt more rapidly and flexibly than large companies to environmental factors or external changes. The existence of SMEs in Indonesia can help the movement of the Indonesian economy, especially after the crisis in 2017 until now. In 2017, SMEs in Indonesia contributed 62.57% of the total GDP (Gross Domestic Product in Indonesia), an increase from 60.34% in 2016 and 57.84% in 2015 (Bank Indonesia, 2018). For this reason, it is not surprising that the government should focus on improving the performance of the SMEs sector in Indonesia (Munandar, 2016). In general, corporate success is defined as the company's operating ability to fulfill the wishes of the company's major shareholders (Smith and Reece, 1999). Another opinion by Wibowo (2008) is the product of work that has a link with strategic organizational goals and contributes to the economy. This research was based on the Resource Advantage Theory (RAT) of Competition (Hunt & Morgan, 1997: 76) and Dynamic Capability (DC) by Teece (1997). The RAT theory argues that the resources owned by a company will affect the market position in the form of competitive advantage, competitive average or competitive disadvantage. The market position will affect the financial performance of a company - superior, average and below the average of other companies that are competing in the competition arena. In creating this competitive advantage, and innovation strategy is needed so that the company can compete in a dynamic environment. To achieve this, the organization must be able to

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continue to perceive and seize opportunities, and periodically change aspects of the organization and culture in order to be able to proactively reposition to address newer threats and opportunities. One way to make this happen is through innovation. This research describes innovation capacity as an organization's ability to effectively develop new concepts, processes, and goods. This suggests that small and medium enterprises (SMEs) companies need the opportunity to produce something new to gain a competitive edge, or what is known as the opportunity to invent. In order to attract new markets and consumers in Indonesia, small and medium enterprises (SMEs) are expected to gain new knowledge and create new products because innovation is the cornerstone for organizations and remain afloat (Hurley et al., 1998). Research studies related to innovation capability on performance has been carried out by Atalay et al. (2013), Bowen et al. (2010), Saunila et al. (2014), Allred and Swan (2005), Wang and Wang (2012) and Aini et al. (2013) Regarding the effects of the potential for innovation on business performance in the Malaysian SME's market, Spain and Finland. The results of these research studies show that the potential for innovation capability has a positive impact on business results, especially for the company's financial performance.

Social capital owned by SMEs is a feature of social network life, norms, and beliefs that allow members of the SME organization to act together so that they can more effectively achieve common goals. As one of the factors influencing SME business performance, social capital in business usually refers to social encounters with various technological, political, bureaucratic, and cultural elites are referred to (Michael and Narayan, 2002; Ozigi, 2018; Saha and Barnejee, 2015). Social capital is important for companies to entry new resources, skills and tools for learning (Adler and Kwon, 2014). Research studies conducted by Sugiyanto and Marka (2017), Oliveira (2013), and Vosta and Jalilvand (2014) examine the effect of social capital measured from 3 aspects, namely cognitive, relational and structural, and its effects on business performance measured through financial and non-financial performance. Furthermore, research studies by Prasetyo and Harjanti (2013) and Hartono and Soegianto (2013) reveal that the overall social capital measured through cognitive, relational, and structural aspects have no significant effect on business performance, both financial and non-financial.

The performance of SMEs is not only affected by social capital factors but it also very much depends on entrepreneurial characteristics and competencies, such as leadership skills, managerial and network skills, technological abilities, and entrepreneurial education levels (Momanyi and Moronge, 2017; Lateh et al., 2018). Therefore, in managing the business, besides having an individual entrepreneurial orientation, one is also required to have good managerial skills. Leadership as an entrepreneurial behavior is very important because it has the potential to recognize values and various aspects related to organizational sustainability, such as encouraging innovation and adapting to change the environment (Renko et al., 2015). Research studies related to entrepreneurial leadership show results where entrepreneurial leadership measured through several measurement indicators consisting of vision, innovation ability, risk-taking and a proactive attitude have a positive effect on business performance (Tarabishy et al., 2005; Rahim et al, 2015; Mgeni et al., 2015). However, in other research studies by Shamsu et al., (2018) and Zainol et al. (2018) – show results that proactive attitude does not affect business performance. In the market performance sense, there are quite a few research studies relevant to entrepreneurial leadership. A research study that demonstrates the entrepreneurial leadership and business performance relationship has not been identified in Indonesia. The same thing can be seen from the research results of Jagdale and Bhola (2014) The findings indicate that entrepreneurial leadership does not have a substantial impact on the organizational performance.

To fill the research gaps between social capital and entrepreneurial leadership on business performance, and also based on several previous research studies that have found the influence of social capital and entrepreneurial leadership on innovation capabilities, as well as to see the importance of innovation capabilities on business performance, the novelty of this study is a variable innovation capability which allegedly acts as a mediating variable. Innovation is important for companies in facing the challenges of competition in the current era of uncertainty (Ali & Iskandar 2016). Until now there has been no research that examines the indirect effect of social capital and entrepreneurial leadership on business performance through innovation capabilities as the intervening, but this is supported by several previous research studies through a direct analysis where the innovation capabilities of a company can also be formed through the quality of human resource elements in the company such as social capital and entrepreneurial leadership. The positive effect of social capital on business innovation capabilities also shows that social ties and networks encourage innovation and enhance a company's innovative capabilities. The results of Jafri et al. (2014), Harjanti (2017), Huang and Chen (2017) and Prihadyanti (2010) Studies have shown that social capital has an important positive influence on innovation capability. Other research studies that promote the relationship between entrepreneurial leadership and innovation capabilities, including the research study conducted by Fontana and Musa (2017) in which they measure how the impact of entrepreneurial leadership is formed from several measurement aspects, namely strategy, communication, motivation and personal/organization on company business innovation. This research study shows that entrepreneurial leadership can create ideas that can directly or indirectly affect innovation. Next, Bagheri (2017) research study also found the positive effect created by entrepreneurial leadership in increasing innovation in terms of innovative work behavior of employees at Hi-Tech SMEs. Based on this background, this study uses a conceptual framework and hypothesis given in Fig. 1 and from the conceptual framework, the research hypotheses are:

H1. Social capital has a significant effect on the innovation capabilities of SMEs.

H2. Entrepreneurial leadership has a significant effect on the innovation capabilities of SMEs.

H3. Social Capital has a significant effect on the performance of SMEs.

H4. Entrepreneurial leadership has a significant effect on SMEs business performance.

H5. Innovation capability has a significant effect on SMEs business performance.

H6. Entrepreneurial leadership has a significant effect on SMEs business performance in mediation by Innovation Capabilities.

H7. Innovation capability has a significant effect on SMEs business performance in mediation by innovation capability.

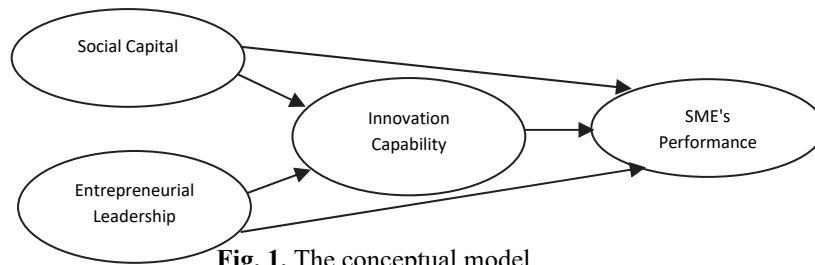


Fig. 1. The conceptual model

## 2. Methodology

### 2.1 Population and Sample

The population in this study are registered Small and Medium Enterprises (SMEs) at the Cooperatives and SMEs Department of Pekanbaru and have started their business for at least 1 year and are still actively operating until now. The number of SME population in this study was 2887 businesses consisting of 2735 small enterprises and 152 medium enterprises. With Slovin calculations, the number of samples used in this study was 352 SME sector companies in Pekanbaru. Of the 352 SMEs as a sample, this study divided them proportionally with a probability sampling technique, namely the Proportional Random Sampling. The Proportional Random Sampling is a sampling plan based on calculations based on the relative size of the item, so that larger items have a greater probability of being selected as samples than small items. For the proportionally calculated sample size, it was obtained 333 Small Enterprises and 19 Medium Enterprises, which would then be used as research samples. Furthermore, the sampling in this study was carried out with a random sampling approach using a random number where SMEs were sorted based on data obtained from the Cooperatives and SMEs Department of Pekanbaru and then a lottery selection was carried out. Every single SME selected was represented by one manager or owner as a respondent, meaning that the respondents in this study consisted of 333 owners/managers of Small Enterprises and 19 owners/managers of Medium Enterprises who are responsible for the SMEs operations in the last one year.

### 2.2 Research Instruments

The instrument used in this study was questionnaires. The research instrument using questionnaires was carried out in 2 ways, namely, a questionnaire was given personally to respondents (Personally Administered Questionnaires to Groups of Individuals) and a questionnaire was given through mail (Mail Questionnaires). Meanwhile, the measurement in the questionnaire was carried out using a 5-point Likert scale. The size of the variables in this study consisted of: Measures of the success/performance variables of SME businesses used in this study were 1) Quality, 2) Time, 3) Finance, 4) Customer Satisfaction, and 5) Human Resources (Hudson et al., 2001). Furthermore, the innovation capability of SMEs was measured through several indicators, namely 1) Learning capability (Albaladejo & Romijn, 2000), 2) Sources of innovation (Filippetti, 2011), 3) Technological efforts (Albaladejo & Romijn 2000), 4) Innovation culture which refers to continuous improvement (Rajapathirana and Hui, 2017; Pinho, 2008), 5) Involvement of external parties (Albaladejo & Romijn, 2000); Pinho, 2008), and 6) Support from other institutions (Albaladejo & Romijn, 2000). Then, the Social capital variable in this study was measured through 3 measurement indicators developed from Nahapiet and Samanta (1998) and Claridge (2004) namely 1) relational capital, 2) cognitive capital, and 3) structural capital. Meanwhile, indicators of entrepreneurial leaders behavior in this study consist of: 1) Proactive (Zyl and Mathur, 2007; Greef, 2014), 2) The tendency to take risks (Chen, 2007; Mokhber et al., 2016; Zyl and Mathur, 2007), 3) Innovative (Zyl & Mathur, 2007), 4) Building commitment (Gupta et al., 2004) and 5) Ethics (Surie & Ashley, 2008).

### 2.3 Validity and Reliability Test

The research instrument designed in this study - before being distributed to 352 respondents - was first tested for the validity and appropriateness of each statement item made in the instrument. For this reason, at this stage, pilot test questionnaires were distributed to 30 respondents, in this case, Small and Medium Enterprises (SMEs). The results of the validity and reliability test of the research instruments in this study obtained that the entire statement items were valid and reliable to be used for the next test.

### 2.4 Analysis of Structural Equation Model with AMOS

The theoretical analysis is used to construct a model that for the next steps is used as the basis. In theoretical studies and hypothesis growth, the concepts and dimensions to be studied from the theoretical model have been developed. The multivariate Structural Equation Model (SEM) approach was used in this analysis, centered on the fact that, relative to other multivariate techniques, SEM can simultaneously combine measurement models and structural models. Besides, SEM techniques also can test direct and indirect effects. The software used for data processing using SEM in this study is AMOS 4.

### 3. Data Analysis and Results

#### 3.1 Goodness Of Fit

SEM model testing (Structure Equation Model) is overall model testing which involves an integrated structural model and measurement model which is the whole of the model. A model that can be said to be good (fit) is if the model is conceptually or theoretically supported by empirical data. The goodness of fit test for the overall model uses the following sizes:

**Table 1**

Goodness of fit indices

No	Goodness of Fit Index	Cut off Value	Results	Fitness
1	Chi-Square <i>Significant Probability</i>	Expected Low $\geq 0.05$	1369.386 0.000	Marginal Fit
2	G F I	$\geq 0.90$	0.824	Marginal Fit
3	A G F I	$\geq 0.90$	0.792	Marginal Fit
4	T L I	$\geq 0.90$	0.946	Good Fit
5	C F I	$\geq 0.90$	0.952	Good Fit
6	N F I	$\geq 0.90$	0.916	Good Fit
7	I F I	$\geq 0.90$	0.952	Good Fit
8	RMSEA	0.05 - 0.08	0.058	Good Fit

Source: AMOS Version 21 (2020)

Based on the results of Table 1, it can be explained that the value of the Goodness of Fit Indices Test for TLI, CFI, NFI, IFI and RSMEA that has been carried out has a fit model result, while GFI and AGFI have marginal fit results, but in this case, the marginal fit results are still acceptable. So that the assumption of the feasibility test model used in this study could be accepted.

#### 3.2 Hypothesis test

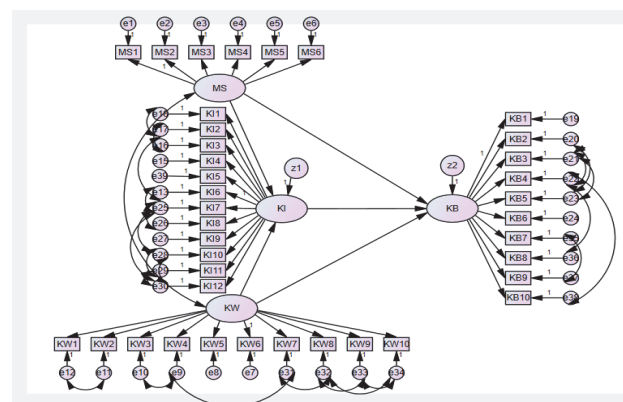
Hypothesis testing is done with a significance level of 0.05 using the t-count. In the AMOS 21 software, the t-count is the critical ratio (cr) value for weight regression. If the critical ratio (cr) value is greater than 1.967 or the likelihood (P) value is  $< 0.05$ , then  $H_0$  is rejected, which implies that the hypothesis is accepted. The results of hypothesis testing in this study are presented in the following table:

**Table 2**

Standardized Regression Weights

No	Endogen Variable		Exogen Variable	C.R.	P	Conclusion
1	Social Capital	→	Innovation Capability	2.973	0.003	Accepted
2	Entrepreneurial Leadership	→	Innovation Capability	10.742	0.000	Rejected
3	Social Capital	→	SME's Performance	0.855	0.393	Accepted
4	Entrepreneurial Leadership	→	SME's Performance	3.779	0.000	Accepted
5	Innovation Capability	→	SME's Performance	2.311	0.021	Accepted

Source: AMOS version 21 (2020)



Note : MS = Social Capital, KW = Entrepreneurial Leadership. KI = Innovation Capability, KB = SME's Performance

**Fig 2. AMOS Model**

#### 3.3 Results Evaluation of the Indirect Effects

Evaluation of the indirect effect in this study was used to further investigate whether there is an indirect effect between exogenous variables (social capital and entrepreneurial leadership) on endogenous variables (business performance) through endogenous variables (innovation capability). To evaluate the indirect effect, the Sobel test was used. The calculation of the Sobel test in this study used the

Sobel calculator <http://quantpsy.org/sobel/sobel.htm> and the results of the calculation can be seen in Fig. 3 and Fig. 4 along with an explanation of the indirect effects in the following:

Input:	Test statistic:	Std. Error:	p-value:
a 0.132	Sobel test: 1.99009107	0.0164495	0.0465809
b 0.248	Aroian test: 1.94313653	0.01684699	0.05199966
s <sub>a</sub> 0.034	Goodman test: 2.04062273	0.01604216	0.04128834
s <sub>b</sub> 0.107	Reset all	Calculate	

Fig. 3. Sobel Calculator 1

Input:	Test statistic:	Std. Error:	p-value:
a 0.71	Sobel test: 2.26576491	0.07771327	0.02346578
b 0.248	Aroian test: 2.25646732	0.07803348	0.02404138
s <sub>a</sub> 0.066	Goodman test: 2.27517838	0.07739173	0.02289523
s <sub>b</sub> 0.107	Reset all	Calculate	

Fig. 4. Sobel Calculator 1

The calculation of the sSobelcalculator in Fig. 3 above shows that the p-value of 0.046 is smaller than the value of 0.05, so in this case there is an indirect effect of social capital on business performance mediated by innovation capabilities. The calculation of the sSobelcalculator in Fig. 4 above shows that the p-value of 0.023 is smaller than the value of 0.05, so in this case, there is an indirect effect between entrepreneurial leadership on business performance mediated by innovation capabilities.

### 3.4 Social Capital and Innovation Capabilities

Based on the results of the examination, it can be inferred that social capital has a significant effect on the SME's innovation capability. In this case, this relationship means that strong SME's social can increase their innovation capability. The development of an innovative environment can be defined as the effect of social capital (Dakhli & Clercq, 2004). This implies that businesses do not innovate in isolation, but require contact with their surroundings. Social capital in the form of formal and informal networks is very important in supporting the innovation of a company including, First, innovation is heavily dependent on knowledge distribution, especially in high technology, where knowledge is very precise. Networks consist of bonds between people inside and between businesses. These bonds enable, assist, and speed up the exchange of information as well as minimize information retrieval costs. Second, there is a synergistic impact of the network, which brings together complementary concepts, expertise, and finance. The networks connect various ideas and creative thoughts. Moreover, the networks do not only facilitate innovation on its own but also help and accelerate the diffusion of innovation (Abrahamson & Rosenkopf, 1997). This finding is in line with the research studies by Jafri et al. (2014), Harjanti (2017), Huang and Chen (2017) and Prihadyanti (2010) which show that social capital measured in terms of relational, cognitive, and structural has a significant positive effect on innovation capabilities.

### 3.5 Entrepreneurial Leadership and Innovation Capabilities

The conclusion from the results of hypothesis testing shows that the social capital variable has a significant effect on innovation capabilities. The relationship shown in the results of this study is positive wherein if the entrepreneurial leadership in SME companies in Pekanbaru is good, then it will have an impact on increasing innovation capabilities. The development of technology, which currently plays an important role in business competition, demands that SME businesses must also be able to take advantage of technology to take market opportunities and competition. For this reason, entrepreneurial leadership by SMEs in Pekanbaru, the majority of which is led by the younger generation who also has a bachelor's level education, is a positive thing that can support these SMEs to innovate. Young and educated leaders today have more capabilities in terms of technology because they are a generation born in the millennial era. This has a positive impact on SMEs in Pekanbaru, which in this study on average already use technology in their activities. Several technology applications that can be used by SMEs include the use of electronic devices, such as e-business, email, websites, e-commerce, and the use of technology in R&D and production activities. SMEs in Pekanbaru City on average already use technology to support their business activities, one of which is the technology for product marketing, such as the use of e-commerce and social media in sales promotion. In the current era of uncertainty, SMEs with entrepreneur-oriented leaders can swiftly execute corporate strategies through sustainable business innovation. The intended organizational innovation is entrepreneurship that is responsive to the latest technology, Creation of production methods that are more aligned with market demands and organizational creativity in the growth of productive and effective business organizations (Fontana and Musa, 2017). This is following the research studies by Shin and Zhou (2007) and Bagheri (2017) which found a positive effect between leadership and organizational innovation in the SMEs sector.

### 3.6 Social Capital and Business Performance

The test results on the variables of social capital and business performance indicate that social capital does not have a substantial impact on business performance. This means that the social capital owned by SMEs does not guarantee a direct increase in business. The relationships with consumers are important in determining company performance because the success of a business depends on consumers. Besides, in Pekanbaru, these SMEs have created a forum or association for the exchange of information and knowledge both formally and informally. Formally the SMEs in Pekanbaru are incorporated in a cooperative managed by the Government under the Cooperatives and SMEs Department, however, not all SMEs have joined this cooperative and the government data collection on SMEs in Pekanbaru is indeed still low. For non-formal associations, these SMEs have also formed many associations such as SMEs Riau, Upload DIY Pekanbaru (@uploadiypekanbaru), and others. This non-formal association is the result of forming social networks through intimacy, solidarity, integration, and trust between SMEs who have the same goals in developing their business. The results of this study are in line with the results of research studies by Prasetyo and Harjanti (2013) and Hartono and Soegianto (2013) which reveal that the overall social capital measured through cognitive, relational, and structural aspects do not have a significant effect on business

performance both financial and non-financial. But, the results of this study are in contrast with the results of research study by Sugiyanto and Marka (2017), Oliveira (2013), and Vosta and Jalilvand (2014) in which the measurement results of social capital with cognitive, relational, and structural indicators and their effect on business performance for both financial and non-financial aspects.

### *3.7 Entrepreneurial Leadership and Business Performance*

Entrepreneurial leadership is a leadership that recognizes how information can be solved and used to create a social context that promotes the development of value and problem solving in SMEs. Entrepreneurial leaders use a method focused on exploration in order to define challenging boundaries and mandate A strategic dedication to new business growth that results in the creation of value. This value creation is very important for SME organizations to be able to sustain their business (Jones and Crompton 2009). Currently, in various countries and Indonesia, many young entrepreneurs are active in building start-ups and developing SME businesses. Likewise in this study, the majority of SME businesses are led and run by young entrepreneurs in the age range of 20-40 years. Research by Dush et al., (2012) found that entrepreneurial leadership by youth in recent years has succeeded in boosting economic competition and increasing development in the area. Entrepreneurial leadership among young people is rarely explored specifically, in fact, policies and programs are often made for one size fit all. Business (today) is no longer synonymous with a business run by those who are mature with all the capabilities and skills to support a business. The results of this study are following the results of research studies by Mgeni (2015), Matzler et al. (2008), and Jagdale and Bhola (2014) which show the strong positive relationship between entrepreneurial leadership and SME business performance, in the sense that the better the entrepreneurial leadership possessed by SMEs, the more it can encourage the improvement of SME performance.

### *3.8 Innovation Capability and Business Performance*

Based on the results of testing, innovation capabilities play an important role in influencing business performance. SMEs can improve their performance both financially and non-financially by developing innovation capabilities to create new products and processes that are more innovative than the competitors'. Innovation is an important determinant of SME business performance in facing today's competition (Calantone et al., 2002). The innovation capabilities of SMEs in Pekanbaru which in this study were measured through learning (learning ability), sources of innovation, technological efforts, and organizational culture that refers to continuous improvement, the involvement of external parties, and support from other institutions are classified as good and on average has been applied by SMEs in Pekanbaru. SMEs in Pekanbaru in terms of increasing innovation capabilities have implemented innovative ways in their business processes including strategies in determining the quality of production raw materials, production processes that already use machine technology, linking with external parties in terms of increasing new knowledge, and also forming organizational culture by always making continuous improvements. Business organizations with high innovation capabilities can help companies respond quickly to existing business opportunities and can take advantage of new products and market opportunities than other non-innovative business organizations. Through innovation activities carried out by the company, even in the difficult competition, the company will always be able to provide new ideas and flexibility in running/operating small and medium sector businesses. This is intended to minimize the impact of the problems and risks faced by SMEs as a result of intense business competition. The results of this study are in line with the results of the research study by Calantone et al., (2002), Jiménez and Valle, (2011), Bowen et al., (2010) which reveal that innovation capability is an important condition to improve performance and increase company value.

### *3.9 Mediation of Innovation Capabilities on Social Capital and business performance*

This study demonstrates that social capital has an indirect impact on business success mediated by innovation capabilities. This means that good social capital will improve the company's capacity for innovation such that it actually has an effect on improving the performance of small and medium-sized businesses-and the company's capacity for innovation acts as a total mediation between the influence of social capital on the performance of the enterprise. Ultimately, the innovation capabilities created by the social capital of SMEs in Pekanbaru have an effect on the improvement of SME efficiency. Innovative businesses have higher efficiency and output than businesses that do not innovate. (Cainelli et al., 2004). SME sector companies that are able can all the resources owned by the company will find it easier to find existing innovations for product innovation, process innovation, and administrative innovation (Rajapathirana & Hui, 2018). The results of this study indicate that innovation capability as a mediating effect between social capital and business performance answers the development of the Resource Based View Theory and Resource Advantage Theory which explain how companies are able to utilize organizational resources to create competitive competition. Social capital owned by individuals in the company is a strategic resource that will never be depreciated (nondepreciable) compared to other productive economic factors. Social capital is generally dynamic in nature so that it can create innovations for SMEs and subsequently have an impact on improving the financial and non-financial performance of SMEs in Pekanbaru. Research study which investigates mediating role of innovation capability in the effect of social capital on business performance has never been done before. However, several studies have found the mediating role of innovation capabilities on several variables that affect business performance, such as in the research conducted by Tjahjadi & Soewarno (2018) where innovation capabilities act as a mediation between the effect of seniority-based management on the business performance of start-up companies in Indonesia. Furthermore, research by Huhtala et al., (2013) also found results where innovation capability plays a role in mediating the effect between market orientation and business performance.

### *3.10 Mediation of Innovation Capabilities on Entrepreneurial Leadership and business performance*

The findings of the indirect impact test of entrepreneurial leadership on business performance through the mediation of innovation capabilities indicate that there is an indirect effect of innovation capabilities mediated by entrepreneurial leadership on business performance. This means that good entrepreneurial leadership is able to increase the company's innovation capabilities so that in the end



it has an impact on improving SME business performance and the company's innovation capabilities act as a full mediation between the effect of leadership on business performance. In the face of today's intense global competition, the application of resource Based Theory and Resource Advantage and Dynamic Capability as the theoretical basis of this research is very suitable to be applied to the scope of small and medium enterprises. The main strategy that must be emphasized in the SME business is the creation value added to gain competitive advantage through resource creation and also the innovation capabilities of the organization. The leadership of SME entrepreneurs in Pekanbaru already has a proactive, innovative attitude, and is brave enough to take risks based on the results of the respondents' responses given. This is able to become capital for the company in developing its innovation capabilities. The role of young leaders or entrepreneurs in managing SMEs in Pekanbaru has one important character that business people in the SME sector must have, namely the ability to innovate by taking advantage of technological developments which are the key in competition in today's digital era. Innovation capabilities that result in improvements to business performance today are Supported by strong mainstream consistency, performance, speed, and versatility capabilities (Lawson and Samson 2001). Innovation can help companies position for businesses.

#### 4. Conclusion

Conclusions can be drawn on the basis of the review and discussion results outlined in the previous chapter to resolve the formulation of research problems including: direct social capital that does not have a major effect on SME business performance in Pekanbaru, but if it is mediated by innovation capacities, then indirect social capital plays a role in improving SME business performance. Next, entrepreneurial leadership, both directly and indirectly mediated by innovation capacities, has a profound impact on SME business success. Meanwhile, the results of the direct impact on innovation capabilities of the variables of social capital and entrepreneurial leadership indicate that social capital and entrepreneurial leadership are directly the factors that shape the innovation capabilities of a SME business.

#### 5. Suggestion

This study tried/aimed to reveal how the application of resource theory in competitive advantage, namely Resource Based Theory and Resource Advantage Theory. However, the results of the study have not found the relationship between business performance and business sustainability because basically competitive advantage aims to make the company continue to grow and maintain its survival in competition. Therefore, further research can further investigate and explain the relationship between the strategies to improve the business performance of SME sector companies to business sustainability.

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